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UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA
SAN FRANCISCO DIVISION

UNITED STATES OF AMERICA,

Plaintiff,

vs.

CHARLES CATHCART, et al.,

Defendants.

Case No. C-07-4762-PJH

**MEMORANDUM OF POINTS AND
AUTHORITIES IN SUPPORT OF
DEFENDANT ROBERT NAGY'S
MOTION TO STAY THE
PROCEEDINGS OR IN THE
ALTERNATIVE TO SEVER ALL
CLAIMS AND TRANSFER VENUE
PURSUANT TO 28 U.S.C. 1404(a)**

Date: September 10, 2008

Time: 9:00 a.m.

Dept.: Room 3, 17th Floor

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I. INTRODUCTION

Plaintiff UNITED STATES OF AMERICA ("United States") filed the present action for injunction ("Injunction Action") against Defendant ROBERT J. NAGY ("Mr. Nagy") and several Co-Defendants on September 17, 2007. This action is primarily based upon alleged violations of 26 U.S.C. 6700. On December 31, 2007 the United States Internal Revenue Service ("IRS") assessed penalties against Mr. Nagy also based on alleged violations of 26 U.S.C. 6700. Mr. Nagy filed claims for refund and abatement of these penalties with the IRS, which were denied on July 8, 2008. Thereafter, on July 15, 2008, Mr. Nagy filed a complaint in the United States District Court for the District of South Carolina seeking a refund of the portions of the penalties paid, abatement of the penalties, a determination that his alleged conduct did not violate 26 U.S.C. 6700, and other relief ("Refund Action"). Mr. Nagy demanded a jury trial in the Refund Action. Based on this, Mr. Nagy now moves the Court to stay the present proceedings to preserve his Seventh Amendment right to a jury trial on the issue of whether his alleged conduct violated 26 U.S.C. 6700, which is common to both the Refund and Injunction Actions.

Mr. Nagy previously moved this Court to sever and transfer all claims against him to the District of South Carolina. On June 27, 2008, the Court denied this motion, without prejudice to renew upon a change of circumstances, primarily due to the fact that Mr. Nagy had not yet filed the Refund Action. Now that Mr. Nagy has filed the Refund Action, in the alternative to a stay of the Injunction Action he moves the Court to sever and transfer all claims against him to the District of South Carolina. Such a transfer is in the interests of justice and would increase the convenience of the parties. It would allow the Refund and Injunction Actions to be consolidated in the District of South Carolina and all claims against Mr. Nagy to be resolved in a single trial. Additionally, a transfer would obviate the need to stay the Injunction Action to preserve Mr. Nagy's right to a jury trial.

II. BACKGROUND

Mr. Nagy is a certified public accountant who lives and works in Charleston, South Carolina, as he has since 1974. Declaration of Robert J. Nagy ("Nagy Declaration") at ¶3, Exhibit 1. Co-Defendant DERIVIMUM CAPITAL, LLC ("Derivium") was a client of Mr. Nagy's, for which he prepared tax returns and to which he provided tax advice. *Id.* at ¶18. Mr. Nagy has never been an employee of Derivium and has never held an ownership interest in Derivium. *Id.* at ¶17.

Derivium is a South Carolina limited liability company and its principle place of business is Charleston, South Carolina. The United States First Amended Complaint ("Complaint") at ¶10, Dkt. No. 57. Derivium has filed for bankruptcy and this proceeding is also in South Carolina. *Id.* All of Derivium's records are in the possession of the bankruptcy trustee in Charleston, South Carolina. Nagy Declaration at ¶20.

The United States filed this Injunction Action pursuant to 26 U.S.C. 7402 and 7408 on September 17, 2007. Complaint, Dkt. No. 57. As grounds for injunction it alleges violations of 26 U.S.C. 6700 and 6701. *Id.* at ¶¶88-95. In order to expedite resolution of these allegations, Mr. Nagy chose not to challenge this Court's jurisdiction over him despite his lack of contacts with California and filed his Answer to the Complaint on November 19, 2007. Answer of Robert J. Nagy, Dkt. No. 3. Then, late in December 2007, the United States, *via* the IRS, assessed penalties against Mr. Nagy of more than \$8 million also based on alleged violations of 26 U.S.C. 6700. Nagy Declaration ¶5. Pursuant to 26 U.S.C. 6703(c)(1) Mr. Nagy paid a portion of these penalties and filed claims for refund on January 23, 2008. *Id.* at ¶6. The IRS denied Mr. Nagy's refund claims on July 8, 2008, a mere two weeks before expiration of the six-month deadline for acting on these claims; one week later, on July 15, 2008, Mr. Nagy filed a complaint in the District of South Carolina for refund of the portions of the penalties paid, abatement of the penalties, a

determination that his alleged conduct did not violate 26 U.S.C. 6700, and other relief. Complaint of Robert J. Nagy, No. 2:08-cv-02555-MNS, Exhibit 2. Mr. Nagy demanded a jury trial in the Refund Action. *Id.*

As a result of the United States' decision to first initiate the Injunction Action in California and then months later assess penalties, Mr. Nagy is now forced to simultaneously litigate the identical issue of whether his alleged conduct violated 26 U.S.C. 6700 in both California and South Carolina. This two-fronted assault on Mr. Nagy has already increased the time and expense he has had to expend in dealing with both cases. He has had to retain counsel in both California and South Carolina. Nagy Declaration ¶8. Mr. Nagy's resources will continue to be unduly depleted as long as both cases proceed in parallel.

III. ARGUMENT

A. THE PROCEEDINGS MUST BE STAYED TO PRESERVE MR. NAGY'S SEVENTH AMENDMENT RIGHT TO A JURY TRIAL ON THE ISSUE OF WHETHER HIS CONDUCT VIOLATED 26 U.S.C. 6700

Under the Seventh Amendment to the Constitution a party's right to a jury trial shall be preserved in suits at common law where the value exceeds \$20. United States Constitution, Amendment VII. This right has been described as "the glory of the English law" and "the most transcendent privilege" that one may enjoy. *Dimick v. Schiedt*, 293 U.S. 474, 485 (1935) quoting Blackstone (Bk. 3, p. 379). The Supreme Court has noted that trial by jury is the preferable way to dispose of issues of fact in civil cases at law. *Id.* at 485-86. Furthermore, because the right to a jury trial "is of such importance and occupies so firm a place in our history and jurisprudence," any attempt to limit it must "be scrutinized with the utmost care." *Id.* at 486.

1. Staying the Injunction Action Will Preserve Mr. Nagy's Seventh Amendment Right to a Jury Trial on the Central Issue of Alleged 26 U.S.C. 6700 Violations by Eliminating the Possibility of Collateral Estoppel

Where an action involves both equitable and legal claims, the legal claims and factual issues underlying them must be determined by a jury prior to the determination of the equitable issues. *Beacon Theatres, Inc. v. Westover*, 359 U.S. 500 (1959). The right to a jury trial cannot be impaired by blending an equitable claim with a legal claim. *Scott v. Neely*, 140 U.S. 106, 109-10 (1891). *Beacon Theatres* involved claims for declaratory relief, injunction, and damages. 359 U.S. at 502-3. The trial court decided the equitable claims first and Beacon applied to the Court of Appeals for a writ of mandamus to vacate the trial court's findings and orders based thereon. *Id.* at 501, 503. Beacon argued that in deciding the equitable issues before the jury determined the legal issues, the trial court violated its Seventh Amendment right to a jury trial. *Id.* at 504. The Supreme Court held that Beacon had a right to a jury trial on the issue of damages and that this right was violated when the trial court decided the equitable claims first. *Id.* at 504, 508. It found that a trial court must use its discretion to preserve a party's Seventh Amendment right to a jury trial "wherever possible." *Id.* at 510.

Where legal and equitable claims are presented simultaneously, a court cannot circumvent its obligation to try the legal issues to a jury first by characterizing those issues as "incidental" to the equitable issues. *Dairy Queen, Inc. v. Wood*, 369 U.S. 469, 470 (1962). Similarly, a court cannot avoid the *Beacon Theatres* rule by erroneously dismissing the legal claims and then deciding the equitable claims itself. *Lytle v. Household Manufacturing, Inc.*, 494 U.S. 545, 555-6 (1990). In *Lytle* a worker sued his former employer for monetary and injunctive relief and demanded a jury trial. *Id.* at 548. The district court dismissed the issues on which Mr. Lytle was entitled to a jury trial and then conducted a bench trial on the remainder. *Id.* at 548-9. The Court of Appeals ruled

1 that the dismissal of the legal claims was erroneous, but that Mr. Lytle was nonetheless
 2 unable to litigate those issues before a jury because the verdict in favor of the defendant
 3 from the bench trial collaterally estopped him. *Id.* at 549. The Supreme Court found that
 4 but for the erroneous dismissal of some of Mr. Lytle's claims, the case would be
 5 indistinguishable from *Beacon Theatres*. *Id.* at 552. As such, the bench trial usurped the
 6 determination of issues that was properly left to a jury. *Id.* Rather than simply hold that
 7 Mr. Lytle was not collaterally estopped from trying the erroneously dismissed claims
 8 before a jury, however, the Court ordered that the district court's decision be vacated and
 9 that the case in its entirety be tried before a jury. *Id.* at 555-6. The Court noted that in
 10 cases where a party's right to a jury trial has been wrongfully denied, its practice is to
 11 reverse and remand for trial of all issues before a jury. *Id.* at 552-3.

12 The Ninth Circuit Court of Appeals addressed the issue of preserving a party's
 13 Seventh Amendment right to a jury trial in a case very similar to the instant case. *United*
 14 *States v. Nordbrock*, 941 F.2d 947 (9th Cir. 1991). Mr. Nordbrock prepared tax returns and
 15 was allegedly a participant in an illegal tax shelter scheme. *Id.* at 948. The IRS sought
 16 from him copies or a list of all returns he had prepared, which Mr. Nordbrock refused to
 17 provide. *Id.* The IRS filed an action to enjoin Mr. Nordbrock from preparing tax returns.
 18 *Id.* It also assessed penalties against him for failure to produce the requested documents.
 19 *Id.* Mr. Nordbrock paid part of the assessment and then filed an action for refund of that
 20 payment and for abatement of the remainder of the penalty assessment, also demanding a
 21 jury trial. *Id.* at 948-9. The two separate actions were eventually consolidated and the trial
 22 court conducted a bench trial with regard to the dispositive issue common to both claims of
 23 whether Mr. Nordbrock's refusal to provide the information was willful. *Id.* at 949.
 24 Before the bench trial Mr. Nordbrock filed a continuing demand for a jury trial and also
 25 moved to stay the injunction action until after a jury trial of the refund action. *Id.* The trial
 26

1 court denied both a jury trial and a stay. *Id.* The Ninth Circuit Court of Appeals held that
 2 Mr. Nordbrock's continuing demand for a jury trial was sufficient to preserve it and to
 3 preclude any waiver. *Id.* at 950. It further held that the bench trial of the dispositive issue
 4 common to both claims violated Mr. Nordbrock's Seventh Amendment right to a jury trial,
 5 citing to *Lytle*. *Id.* at 949. It then reversed and remanded the case. *Id.* at 950.

6 The circumstances of the present case with respect to Mr. Nagy are governed by the
 7 *Beacon Theatres* rule and are remarkably similar to those of *Nordbrock*. As in *Nordbrock*,
 8 so too here there are two separate actions, one for injunction and the other for refund and
 9 abatement of penalty assessments. Similar to Mr. Nordbrock, Mr. Nagy is also entitled to
 10 and has also demanded a jury trial with respect to the Refund Action. Complaint of Robert
 11 J. Nagy, No. 2:08-cv-02555-MNS, Exhibit 2. Trying the dispositive issue in *Nordbrock* at
 12 a bench trial violated the Seventh Amendment. Based upon this Motion, trying the
 13 Injunction Action first would permit collateral estoppel to apply to the Refund Action,
 14 denying Mr. Nagy his right to a jury trial in that action. The fact that the two actions
 15 involving Mr. Nagy are presently distinct does not change the conclusion that the common,
 16 dispositive issue of whether his alleged conduct violated 26 U.S.C. 6700 must be tried to a
 17 jury before the court may decide the claim for injunction. All the same reasons in *Beacon*
 18 *Theatres* and *Nordbrock* as to why the legal claims must be heard by a jury before the
 19 court determines the equitable claims also apply to the present situation where the legal
 20 and equitable claims happen to be in contemporaneous parallel actions.

21 There are at least two ways in which a trial court may preserve a party's right to a jury
 22 trial where both legal and equitable claims are involved. It may grant a jury trial with
 23 respect to all issues, or it may stay the equitable claims until the legal claims are decided
 24 by a jury. In either case, pursuant to the rule in *Beacon Theatres*, the court is obligated to
 25 allow a jury to decide the common issues "wherever possible." *Beacon Theatres, Inc. v.*

1 *Westover, supra*, 359 U.S. at 510. In the present case it is certainly possible for the Court
 2 to stay the Injunction Action to allow the issues of alleged violation of 26 U.S.C. 6700 to
 3 be tried before a jury in the Refund Action.

4 **2. Staying the Injunction Action Will Prevent Hardship and Inequity to Mr. Nagy**
 5 **and Will Be in the Interests of Justice by Preserving the Constitutional Right to**
 6 **a Jury Trial**

7 This Court has the power to stay the proceedings incident to its power to control the
 8 disposition of cases on its docket in an economic and timely manner. *Landis v. North*
 9 *American Co.*, 299 U.S. 248, 254 (1936). Exercising this power requires the Court to use
 10 its discretion. *Id.* at 259. In deciding whether to grant a stay, a court must weigh the
 11 competing interests that will be affected by the stay or lack thereof. *CMAX, Inc. v. Hall*,
 12 300 F.2d 265, 268 (9th Cir. 1962). This analysis involves consideration of the harm that
 13 may result from the granting of a stay, the hardship or inequity a party may suffer if the
 14 case continues without a stay, and the orderly course of justice insofar as issues may be
 15 simplified or complicated as a result of a stay. *Id.*

16 In a case where a freight forwarding company instituted an action for payment of
 17 tariffs under a contract, a stay was proper once the enforcement arm of the Civil
 18 Aeronautics Board brought an action against the freight forwarding company on the
 19 grounds that it was charging improper tariffs. *Id.* at 266. The freight forwarding company
 20 was simultaneously pursuing numerous actions for collection of tariffs. *Id.* at 267. The
 21 district court granted the stay, reasoning that resolution of the enforcement action by the
 22 Civil Aeronautics Board would likely affect all the pending cases, including the one before
 23 it. *Id.* The Court of Appeals upheld the stay because the freight forwarding company
 24 failed to show that the stay would irreparably harm it or constitute a miscarriage of justice.
 25 *Id.* at 268-9. The only potential prejudice the company could suffer as a result of the stay
 26 stems from the results of the enforcement action, which may adversely affect its contract

1 claim. *Id.* at 269. But this type of prejudice, the Court of Appeals notes, does not form a
 2 basis for denying a stay. *Id.* In fact, justice will be served insofar as any weakness in the
 3 contract action is exposed prior to trial of that claim. *Id.* In other words, the stay will
 4 allow the propriety of the tariffs to be determined in the enforcement action, which will
 5 advance the orderly course of justice by simplifying that issue in the contract action. This
 6 effect, therefore, although potentially adverse to the company, actually weighs in favor of
 7 the stay. *See id.*

8 In the present case a stay is likewise appropriate. If a stay is not granted and the
 9 issue of whether Mr. Nagy's conduct violated 26 U.S.C. 6700 is decided in the Injunction
 10 Action, Mr. Nagy may be collaterally estopped from trying that issue before a jury in the
 11 Refund Action. This would constitute a violation of his Seventh Amendment right to a
 12 jury trial pursuant to *Beacon Theatres* and *Nordbrock*. Certainly the violation of a
 13 constitutional right qualifies as hardship or inequity sufficient to overcome any adverse
 14 affects of a stay on the United States. Furthermore, as in *CMAX*, granting a stay in this
 15 case will advance the orderly course of justice by simplifying an issue. If a stay is granted,
 16 the dispositive issue of whether Mr. Nagy's alleged conduct violated 26 U.S.C. 6700 will
 17 be resolved in the Refund Action, thereby simplifying that issue for this Court.

18 **B. IN THE ALTERNATIVE TO STAYING THE PROCEEDINGS, THE COURT**
 19 **SHOULD SEVER AND TRANSFER ALL CLAIMS AGAINST MR. NAGY TO**
 20 **THE DISTRICT OF SOUTH CAROLINA**

21 As an alternative to staying the present proceedings to preserve Mr. Nagy's Seventh
 22 Amendment right to a jury trial, this Court may sever all claims against him under Federal
 23 Rule of Civil Procedure ("FRCP") 21 and transfer them to the District of South Carolina,
 24 Charleston Division pursuant to 28 U.S.C. 1404(a). This transfer would serve the interests
 25 of justice by enabling the Injunction Action to be consolidated with the Refund Action and
 26 allowing the issue of whether Mr. Nagy's conduct violated 26 U.S.C. 6700 to be

determined by a jury in the consolidated action. Transfer of the claims against Mr. Nagy to the District of South Carolina would also serve the convenience of the parties insofar as it would obviate the need to stay the present proceedings to protect Mr. Nagy's Seventh Amendment right.

1. Transfer to South Carolina Is in the Interests of Justice and More Convenient for the Parties

28 U.S.C. 1404(a) provides for transfer of an action to another venue. The purpose of this statute is to foster efficiency and to protect against unnecessary inconvenience and expense. *Van Dusen v. Barrack*, 376 U.S. 612, 626 (1964). This section is a revision of the common law doctrine of *forum non conveniens* that gives judges broader discretion and requires case-by-case consideration of convenience and fairness. *Id.* at 622. A case should be transferred pursuant to 28 U.S.C. 1404(a) if (1) the transferee district is one where the action might have been brought, and (2) it will serve the convenience of the parties and witnesses and will promote the interests of justice. *Goodyear Tire & Rubber Co. v. McDonnell Douglas Corp.*, 820 F.Supp. 503, 506 (C.D. Cal. 1992).

a. The claims against Mr. Nagy might have been brought in South Carolina

The requirement that transfer is only appropriate to a venue where a case might have been brought refers to federal rules of venue. *Van Dusen v. Barrack*, *supra*, 376 U.S. at 624. Venue is appropriate in a federal question case in a judicial district in which a substantial part of the events giving rise to the claim occurred. 28 U.S.C. 1391(b)(2). The majority of events in the present case giving rise to the Injunction Action occurred in South Carolina. Derivium was a South Carolina company with its principle place of business in Charleston. Mr. Nagy lived and work in South Carolina at all times relevant to this matter. Mr. Nagy provided tax advice to Derivium in South Carolina. As such, South Carolina is a venue where this case might have been brought.

b. The factors for determining the interests of justice and convenience weigh in favor of transfer to South Carolina

Courts apply a multi-factor balancing test to determine whether the convenience of the parties and the interests of justice favor transfer. *Goodyear Tire & Rubber Co. v. McDonnell Douglas Corp.*, *supra*, 820 F.Supp. at 507. These factors include: relative ease of access to sources of proof; judicial economy and the fair administration of justice; convenience of the witnesses and the availability of compulsory process; convenience of the parties; plaintiff's choice of forum; the connections between the forum and the parties and cause of action; the difference in cost of litigation between forums; docket congestion; ease of monitoring and enforcing injunction; the state most familiar with governing law. *Jones v. GNC Franchising, Inc.*, 211 F.3d 495, 498-499 (9th Cir. 2000).

In Mr. Nagy's previous Motion to Sever All Claims and Transfer Venue Pursuant to 28 U.S.C. 1404(a) each *Jones* factor was individually analyzed to demonstrate that transfer to South Carolina is in the interest of justice and serves the convenience of the parties and witnesses. *See* Dkt. No. 66 at 8-17. Such an analysis would be superfluous at present, however, because the main change of circumstances between the prior Motion and the instant Motion makes it readily apparent that transfer to the District of South Carolina is in the interest of justice and serves the convenience of the parties. As shown above, now that the Refund Action has commenced in South Carolina, pursuant to *Beacon Theatres* it is necessary to stay the Injunction Action to preserve Mr. Nagy's Seventh Amendment right to a jury trial on the common issue of whether his alleged conduct violated 26 U.S.C. 6700.

All parties will be inconvenienced if the present action is stayed, notwithstanding the fact that this inconvenience is out-weighted by the paramount importance of safeguarding Mr. Nagy's right to a jury trial. Further, it is also obviously in the interest of justice to preserve a party's constitutional right to a jury trial. Transfer of the Injunction

1 Action against Mr. Nagy to South Carolina relieves the United States and remaining Co-
 2 Defendants of the inconvenience that will result if the entire Injunction Action is stayed by
 3 allowing the Injunction Action to continue against those Co-Defendants. Transfer also
 4 preserves Mr. Nagy's right to a jury trial by allowing the Refund and Injunction claims to
 5 be consolidated in one trial that may then be heard by a jury. These reasons alone are
 6 sufficient to warrant transfer of the injunction claims against Mr. Nagy to the District of
 7 South Carolina.

8 **2. The Court May Sever Claims under F.R.C.P. 21 to Effectuate Transfer**
 9 **pursuant to 28 U.S.C. 1404(a)**

10 A court must generally retain or transfer an entire action because partial transfer is
 11 not authorized by 28 U.S.C. 1404(a). *Chrysler Credit Corp. v. Country Chrysler, Inc.* 928
 12 F.2d 1509, 1518 (10th Cir. 1991). A separate and distinct action is created when claims are
 13 served under FRCP 21, however. *Id.* This new action may then be transferred pursuant to
 14 28 U.S.C. 1404(a). *Id.*; *Wyndham Assoc. v. Bintliff*, 398 F.2d 614, 618 (2nd Cir. 1968) cert.
 15 denied Dec. 9, 1968, 89 S.Ct. 444. FRCP 21 plainly states that "The court may also sever
 16 any claim against a party." This broad language gives the court wide discretion to sever
 17 claims. No published case in the Ninth Circuit restricts a court's ability to sever a claim in
 18 order to effectuate a transfer pursuant to 28 U.S.C. 1404(a).

19 Courts in other Circuits have exercised their discretion to sever claims under FRCP
 20 21 to effectuate transfer. The Second Circuit Court of Appeals, for example, has found
 21 that where the interests of justice would be advanced by transfer, a court may sever claims
 22 to make that transfer possible. *Wyndham Assoc. v. Bintliff*, *supra*, 398 F.2d at 618; *see*
 23 *also In re: Eastern District Repetitive Stress Injury Litigation*, 850 F.Supp. 188, 193-96
 24 (E.D.N.Y. 1994). In the Third Circuit a district court has also noted that severance is
 25 appropriate where it will serve the ends of justice. *CVI/Beta Ventures, Inc. v. Custom*
 26 *Optical Frames, Inc.*, 896 F.Supp. 505, 506 (D.Md. 1995). Insofar as the interests of

1 justice are served by preserving a party's right to a jury trial and by avoiding
2 inconvenience to all parties, severing the claims against Mr. Nagy in the instant case to
3 effectuate transfer also contributes to the ends of justice.

4 **IV. CONCLUSION**

5 The Court must preserve Mr. Nagy's right to a jury trial one way or another. A stay
6 of the Injunction Action will preserve this right, but will also unavoidably result in
7 inconvenience to the parties. Severing all claims against Mr. Nagy and transferring them
8 to the District of South Carolina, where they may be consolidated with the Refund Action,
9 also preserves Mr. Nagy's right to a jury trial, but does not increase the inconvenience of
10 the parties because it obviates the need for a stay. For these reasons and others given
11 above, the Court must grant this Motion.

12
13 DATED: July 30, 2008

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